

AUDIT OF SBA'S FY 1999 FINANCIAL STATEMENTS

MANAGEMENT LETTER

AUDIT REPORT NO. 0-13

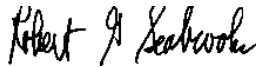
MARCH 29, 2000

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**U.S. SMALL BUSINESS ADMINISTRATION
OFFICE OF INSPECTOR GENERAL
WASHINGTON, D.C. 20416**

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| AUDIT REPORT |
| Issue Date: March 29, 2000 |
| Number: 0-13 |

To: Joseph P. Loddio, Chief Financial Officer



From: Robert G. Seabrooks, Assistant Inspector General for Auditing

Subject: Audit of SBA's FY 1999 Financial Statements – Management Letter

Pursuant to the Chief Financial Officers Act of 1990, attached is the Independent Auditor's Management Letter, issued by Cotton & Company, LLP. The report identifies conditions related to (1) subsidy modeling and re-estimating, (2) safeguarding computer equipment, and (3) duplicate payments. The conditions were identified during the audit of SBA's Fiscal Year 1999 financial statements, but were not required to be included in the Auditor's Report. Also attached is your response to the draft report, in which you generally agreed with the findings and recommendations.

The finding in this report are based on the auditors' conclusions, and the report recommendations are subject to review, management decision, and action by your office in accordance with existing Agency procedures for audit follow-up and resolution. Please provide your management decisions for the recommendations within 30 days using the attached SBA Forms 1824, Recommendation Action Sheet.

Should you or your staff have any questions, please contact Robert G. Hultberg, Acting Director, Business Development Programs Group at (202) 205-7204.

Attachments

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February 14, 2000

MANAGEMENT LETTER COMMENTS INDEPENDENT AUDIT OF FISCAL YEAR 1999 FINANCIAL STATEMENTS

Inspector General
U.S. Small Business Administration

We have audited the U.S. Small Business Administration's (SBA) principal financial statements as of September 30, 1999, and for the year then ended, and have issued our reports, dated February 14, 2000, to SBA under separate cover. Those reports included our reports on SBA's internal control and compliance with laws and regulations.

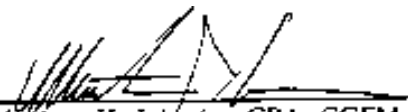
The purpose of this management letter is to communicate three nonreportable findings to SBA management. Of these three, we reported Finding No. 1 in our Fiscal Year 1998 report on SBA's internal control.

This letter is intended solely for the information and use of SBA management.

We would like to express our appreciation to the SBA representatives who assisted us in completing our audit. They were always courteous, helpful, and professional.

Very truly yours,

COTTON & COMPANY LLP

By 
Matthew H. Johnson, CPA, CGFM

**INDEPENDENT AUDIT OF FISCAL YEAR 1999
FINANCIAL STATEMENTS
U.S. SMALL BUSINESS ADMINISTRATION
NONREPORTABLE FINDINGS**

Certain nonreportable findings came to our attention during the audit of the U.S. Small Business Administration's (SBA) Fiscal Year (FY) 1999 financial statements. All findings are related to SBA's internal control.

We reported Finding No. 1 in our FY 1998 audit report on internal control. Where SBA partially addressed our recommendations, we modified our findings and recommendations.

1. Subsidy Modeling and Re-Estimation Process

SBA's quality control process over subsidy modeling and re-estimating, while much improved, still is not completely effective. In our FY 1998 audit report on internal control, we recommended that the Office of the Chief Financial Officer (OCFO):

- Continue to refine its quality assurance process to ensure that peer and supervisory reviewers have the experience, training, and time to perform reviews commensurate with the inherently high risk associated with SBA's existing re-estimate process.
- Arrange for an independent review of the new disaster models and ensure that the new models produce reliable and reasonable re-estimates before submitting the re-estimates for audit.

In response to these recommendations, SBA developed comprehensive policies and procedures for preparing subsidy estimates and re-estimates, which included an overview of the process, programs, and assumptions; data documentation and training requirements; and deliverables and a timeline for their completion. SBA also improved its quality assurance process to include peer review by an analyst not responsible for preparing the re-estimate as well as a supervisory review.

Further, SBA designed a new cash flow model for disaster budget submission as well as re-estimates. As recommended, SBA relied upon the review of an independent contractor to ensure that the new model produced reliable and reasonable re-estimates.

Even with these improvements, we found cell reference errors and computational errors, as well as inconsistent treatment of Office of Management and Budget-prescribed interest rates within spreadsheets prepared for SBA's separate programs. We did note, however, that the number of errors and associated dollar amounts were reduced from last year.

We found that most errors occurred when a model had to be revised, but was not completely reviewed as the result of time constraints. We also found that peer and supervisory reviews were generally effective, even though SBA did not have procedures in place to ensure that each review was thorough and performed consistently among programs.

We recommend that the Chief Financial Officer (CFO) direct the Director of the Office of Financial Analysis to:

- Continue to document and standardize the subsidy modeling and re-estimation process and quality reviews now in place.
- Develop a checklist for use by both the preparer and the reviewer of the subsidy model and re-estimates.
- Update the policy and procedures manual annually.
- Require a review of all models when any modifications are made.

2. **Safeguarding Computer Equipment**

As part of our audit, we attempted to conduct inventories of computer equipment at various offices we visited. Specifically, we attempted to obtain inventory listings of personal computers and verify existence through observation. We could not conduct these tests, however, because SBA does not have a centralized computer inventory database, and program and field offices do not keep adequate, up-to-date inventories of computer equipment. Further, we found that surplus computers are not properly sanitized of data before disposal.

The General Accounting Office's (GAO) *Standards for Internal Control in the Federal Government* states that an agency must establish physical control to secure and safeguard vulnerable assets and such assets should be periodically counted and compared to control records.

SBA does not have written procedures or standardized practices for tracking and disposing of computer equipment. As a result, computer equipment is not properly controlled.

We recommend that the CFO:

- Develop written procedures and policies for tracking and disposing of computer equipment.
- Establish a centralized inventory database.
- Perform periodic inventories of computer equipment and compare results to the inventory database.
- Establish disposal procedures for computer equipment that include sanitizing data remaining on hard drives of surplus equipment.

3. **Duplicate Payments**

SBA provides grants to Small Business Development Centers (SBDC). An SBDC requests reimbursement of expenses incurred by periodically submitting a Request for Funds form to SBA. Before reimbursing expenses, SBA's Denver Finance Center (DFC) verifies that obligations exist within the Federal Financial System (FFS) to cover the amount of the invoice.

In conducting testing over payments to SBDCs, we randomly selected 50 payments and verified the appropriateness of these payments. In our sample, we found a duplicate payment for \$289,499. As a

result, we expanded our testing to determine whether other duplicate payments existed. To accomplish this, we sorted all payments by dollar amount and extracted those in which the same amount was listed more than once. We identified one other duplicate payment for \$36,216.

Duplicate payments totaling \$325,715 occurred when SBA paid on the basis of a faxed copy of the Request for Funds form and paid again when the original document was received. Further, the system allowed the processing of duplicate payments, because obligations outstanding for the SBDCs exceeded the duplicate payment amounts.

In response to our finding, DFC immediately contacted the SBDCs and requested refunds for the duplicate payments.

We recommend that the CFO direct the DFC Director to:

- Establish controls within FFS requiring entry of a control number from the Request for Funds form and rejection of requests with duplicate numbers.
- Pay SBDC requests only from original documents.
- Verify that no duplicate payments have occurred in the past 3 years.

U.S. SMALL BUSINESS ADMINISTRATION
WASHINGTON, D.C. 20416

DATE: MARCH 3, 2000

TO: Robert G. Seabrooks
Assistant Inspector General
for Auditing

FROM: Joseph P. Loddo 
Chief Financial Officer

SUBJECT: Audit of SBA's FY 1999 Financial Statements – Management Letter

We have reviewed the draft management letter by Cotton & Company for SBA's FY 1999 financial audit. The SBA is committed to prompt and effective attention to all items in its financial audit. Cotton has identified three non-reportable items including 1) subsidy modeling, 2) personal computer inventories and 3) SBDC duplicate payments. We are pleased to note that the first item on subsidy rates was downgraded this year from a reported material internal control weakness, and we are working now to eliminate this item. The other two items are new this year and we have already begun work to eliminate them for FY 2000. We are also pleased to note that the two items in your FY 1998 management letter on SBDC agreements and capitalized property have been addressed by SBA and are not repeated in this year's letter. Further comments on the three items in your FY 1999 management letter follow.

1. Subsidy Modeling and Re-estimation Process

We appreciate Cotton's recognition of the SBA's improvements to this process and are proud to note that for FY 1999, credit subsidy processing was completed on time without material errors. We are committed to further improvements to our standard procedures for the subsidy process and also improved quality assurance activities in order to eliminate this weakness. We will further update our policy and procedures manual governing the subsidy process. It is updated each Spring by the subsidy analysts, and this year the Disaster model will receive special attention. We will improve upon the quality assurance checklist and reviews already in place. Our response to your final audit report for the management letter will provide details on these improvements.

2. Safeguarding Computer Equipment

The SBA currently has an inventory control system in place that safeguards our computer equipment against material loss. The Fixed Asset Accounting System (FAAS) provides a system and a standardized process to update inventories of computer and other equipment. In addition, our Office of the Chief Information Officer conducts inventories of computer equipment several

times a year. SBA office information technology personnel also maintain inventories of their computer equipment. These measures are sufficient considering the risk of loss to provide adequate safeguards against material losses.

The SBA will implement improvements to our current inventory of computer equipment to address the issues raised by Cotton. A vendor maintained asset tracking system possibly using barcodes will be maintained for all computer equipment purchased beginning in FY 2000 that shows the location of all equipment by ship-to point. Also, automated tools will be used to identify and track all hardware and software assets attached to the Agency's network in the near future. Finally, procedures for the disposal of computer equipment that sanitize data on hard drives for obsolete equipment will be developed. The response to your final audit report on the management letter will provide further details on improvements to this item.

3. Duplicate Payments

Our financial office in Denver has already begun improvements to avoid duplicate disbursements on SBDC grants. A reconciliation of payments over the last three years has been completed to verify that no additional duplicate payments occurred. A new form will be used to better control requests for SBDC disbursements and a standardized procedure will be used to pay from fax copies, with a review of original copy requests received. Our response to your final audit report for the management letter will provide details on these improvements.

The SBA is committed to being a 21st century leading-edge institution. Part of this commitment is the prompt, effective attention to all financial audit items. Therefore, we look forward to working with you and our external auditor, Cotton & Company, during FY 2000 to resolve these three management letter items. Any questions may be addressed to John Kushman or Louise Wilson of my staff.

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